

Message Text

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C O N F I D E N T I A L SEOUL 6240

HONG KONG FOR REGFINATT

E.O. 11652: XGDS-1

TAGS: EFIN, ETRD, IMF, KS

SUBJECT: IMF MISSION DISCUSSES NEW STANDBY AGREEMENT

REF: (A) SEOUL 1470 (B) SEOUL A-151 (C) SEOUL 6019

SUMMARY: IMF MISSION HEADED BY JOACHIM AHRENSDORF AGREED WITH ROKG OFFICIALS DURING JULY 26- AUGUST 9 CONSULTATIONS ON NEW STANDBY AGREEMENT SUBJECT TO IMF BOARD APPROVAL. PROPOSED AGREEMENT COVERS 12 MONTHS BEGINNING JULY 1, 1975 AND IS SUBSTITUTE FOR CY1975 AGREEMENT DRAFTED DURING FEB. CONSULTATIONS (REF A) BUT NEVER PROPOSED TO BOARD. NEW AGREEMENT PROVIDES FOR 30 PERCENT INCREASE IN DOMESTIC CREDIT OR ONLY ABOUT HALF THAT OF YEAR-EARLIER PERIOD. SOME INTEREST RATES TO BE INCREASED AND APRIL TRADE RESTRICTIONS TO BE OFFSET. KOREANS WILL ATTEMPT SECURE EXTENDED FUND FACILITY IN 1976 THROUGH SUBMISSION OF 3-YEAR PROGRAM IN DECEMBER FOR REVIEW IN FEB. BY NEXT CONSULTATIONS
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MISSION. END SUMMARY.

1. DOMESTIC CREDIT. KEY ISSUE IN DISCUSSIONS, WHICH WENT GENERALLY WELL ACCORDING BOTH SIDES, WAS CEILING ON JUNE TO JUNE INCREASE IN

DOMESTIC CREDIT. THIS FINALLY AGREED AT 29.8 PRCT, OR ABOUT HALF OF 57.2 PERCENT INCREASE FOR YEAR-EARLIER PERIOD. A 31.2 PERCENT INCREASE FOR CY1975 WAS ORIGINALLY AGREED IN FEBRUARY. THIS INCREASE WAS LATER REALISTICALLY AMENDED BY KOREANS TO 35.3 PERCENT AND THIS LEVEL CONSTITUTES DEC. 31 CEILING UNDER NEW AGREEMENT. DECEMBER CEILING PERMITS 13.6 PERCENT INCREASE IN SECOND HALF 1975, AFTER 19.2 PERCENT INCREASE IN FIRST HALF. (IMPORTANT STUMBLING BLOCK TO APPROVAL OF PROPOSED FEB. AGREEMENT WAS PROPOSED 23.4 PERCENT CREDIT INCREASE IN FIRST HALF 1975). DUE TO MONETARY EFFECT OF REDUCED FOREIGN EXCHANGE DEFICITS, MONEY SUPPLY EXPECTED INCREASE 34 PERCENT JUNE TO JUNE, COMPARED TO SMALLER 27 PERCENT INCREASE IN YEAR-EARLIER PERIOD.

2. GOVERNMENT BORROWING. CEILINGS AGREED CALL FOR DECREASE IN ROKG BORROWING FROM CENTRAL BANK FROM 146 BILLION WON IN FIRST HALF 1975 TO 119 BILLION WON IN SECOND HALF AND ONLY 30 BILLION WON IN FIRST HALF 1976. THIS BORROWING INCLUDES THAT FOR SPECIAL ACCOUNTS, CHIEFLY FOR GRAIN MANAGEMENT FUND, BUT EXCLUDES THAT FOR SEPARATE FERTILIZER ACCOUNT, WHICH IMF MISSION HAD WISHED TO INCLUDE. (FERTILIZER DEFICIT WAS 90 BILLION WON IN FIRST HALF 1975 AND IS EXPECTED TO BE 60 BILLION WON IN SECOND HALF- SEE REF B FOR LATEST FISCAL DATA.) ROKG MEASURES TO REDUCE LARGE GRAIN AND FERTILIZER DEFICITS APPARENTLY INCLUDE: GENERAL BUDGET SURPLUS OF 30 BILLION WON TO BE PROPOSED IN SEPT. SUPPLEMENTAL BUDGET; LIMITATION OF NOV.-INCREASE IN PRODUCER RICE PRICES TO 20 PERCENT; INCREASE IN CONSUMER GRAIN PRICES EARLY IN 1976; END TO COSTLY BUILDUP OF GOVERNMENT GRAIN STOCKS UNDERTAKEN IN 1975; AND ELIMINATION OF MOST OR ALL OF FERTILIZER SUBSIDY TO FARMERS EARLY IN 1976.

3. INTEREST RATES. UNDER STRONG PRESSURE FROM IMF, INCLUDING JUNE BOARD MEETING RE OIL FACILITY DRAWING, ROKG AGREED TO SOME INCREASE IN SOME INTEREST RATES BY END OF YEAR, TO REFLECT TIGHTER MONEY POLICY AND HIGH RATE OF INFLATION (WHOLESALE PRICE INDEX UP 15 PCT IN FIRST 7 MONTHS 1975). PRIME BANK LENDING RATE OF 15.5 PCT UNLIKELY TO BE CHANGED, HOWEVER.

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4. IMPORT RESTRICTIONS. KOREANS AGREED TO OFFSET BY NEXT MARCH \$67 MILLION EFFECT OF RESTRICTIONS ON 39 ITEMS IMPOSED LAST APRIL THROUGH LIBERALIZATION THOSE OR OTHER ITEMS. (RESTRICTIONS THUS BECOME TEMPORARY FOR OIL FACILITY PURPOSES BY BEING OFFSET WITHIN 12 MONTHS.) EMBOFF DISCUSSED NEW MACHINERY IMPORT CERTIFICATION

PROCEDURES (REF C) WITH MEMBER OF MISSION, WHO SAID ADVERSE EFFECTS, IF ANY, WOULD BE EXAMINED NEXT FEBRUARY.

4. FOREIGN BORROWING. NEW DRAFT STANDBY PROVIDES FOR NEARLY \$2 BILLION IN 1-15 YEAR NON-BANK BORROWING, EQUAL TO FOREIGN LONG-TERM CAPITAL REQUIREMENTS LEVEL AGREED AT RECENT CG. OF TOTAL, UP TO \$450 MILLION MAY BE ON 1-3 YEAR TERM; OF THIS KOREANS SAY THEY

HOPE FOR \$200 MILLION IN CCC COTTON CREDITS. IN ADDITION FOREIGN MONETARY LIABILITIES CAN, IF NECESSARY, INCREASE \$365 MILLION JUNE TO JUNE. ON JUNE 30 THEY TOTALLED \$1,732 MILLION, OF WHICH \$400 MILLION WERE LONG TERM. NO MINIMUM SET FOR NET FOREIGN ASSETS, WHICH WERE MINUS \$542 MILLION ON JUNE 30.

5. EXCHANGE RATE. CHANGE IN BASIC RATE REPORTEDLY DID NOT COME UP IN FORMAL MEETINGS ALTHOUGH STAFFS DISCUSSED POSSIBLE ADVANTAGES OF FUTURE SHIFT TO CRAWLING PEG ARRANGEMENT A LA BRAZIL. LINK TO MULTIPLE CURRENCIES (RATHER THAN DOLLAR ONLY) AGAIN CONSIDERED BUT KOREANS DO NOT LIKE DAILY RATE FLUCTUATIONS, WHICH THEY ABANDONED FOR RIGID RATE IN APRIL 1974.

6. STANDBY CREDIT. WHEN APPROVED, STANDBY WILL MAKE AVAILABLE SECOND CREDIT TRANCHE OF SDR 20 MILLION, WHICH KOREANS CONSIDER TOO SMALL TO DRAW IN VIEW POSSIBLE PSYCHOLOGICAL DISADVANTAGES.

7. EXTENDED FUND FACILITY. KOREANS SAY MISSION TOLD THEM FUND WISHES TO MOVE SLOWLY ON KOREAN REQUEST AND ASKED THEM SUBMIT IN DECEMBER A 3-YEAR PLAN TO REDUCE BOP AND FISCAL DEFICITS AND RATE OF INFLATION. NEXT CONSULTATIONS MISSION IN FEB. WILL REVIEW PLAN. EARLIEST BOARD APPROVAL WOULD BE IN APRIL. IMF DELAY IN CONSIDERATION OF KOREAN REQUEST FOR EARLY CREDIT OF SDR 112 MILLION UNDER EXTENDED FUND FACILITY AND CURRENT PESSIMISTIC OUTLOOK FOR FULL OIL FACILITY FUNDING TO GETHER RESULT IN SUBSTANTIAL REDUCTION IN IMF FINANCING IN 1975, COMPARED TO EARLIER EXPECTATIONS.

8. COMMENT: CHIEF CONCERNS OF IMF MISSION WERE LARGE FISCAL AND BOP
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DEFICITS. KOREAN POSITION IS THAT LITTLE CAN BE DONE TO REDUCE LARGE GRAIN AND FERTILIZER SUBSIDIES UNTIL TURN OF YEAR, POINTING OUT FERTILIZER PRICES TO FARMERS WERE RAISED 65 PCT LAST DEC. AND CONSUMER GRAIN PRICES AN AVERAGE OF 25 PCT IN APRIL. AS CONCESSION, KOREANS PROPOSED SHIFT FROM GENERAL BUDGET BALANCE (ON THEIR DEFINITION) TO SMALL SURPLUS IN 1975 THROUGH HOLDING DOWN EXPENDITURES IN SUPPLEMENTAL BUDGET. IMF STAFF REPORTEDLY BELIEVES BOP CURRENT ACCT DEFICIT MAY REMAIN CLOSE TO \$2 BILLION FOR NEXT FEW YEARS AND THAT 3-YEAR PROGRAM UNDER EXTENDED FACILITIES NEEDED TO SECURE SUBSTANTIAL IMPROVEMENT. KOREANS CONSIDER IT TOO EARLY TO HAVE GOOD BOP FORECAST FOR 1976 (WE AGREE) BUT GENERALLY EXPECT ONLY \$2-300 MILLION REDUCTION IN DEFICIT. WHILE BOP AND FX SITUATION CONTINUED TO IMPROVE IN JULY, WE STILL EXPECT 1975 CURRENT ACCOUNT DEFICIT OF AROUND \$2.2 BILLION.

9. IMF FAILURE TO APPROVE EARLIER DRAFT STANDBY AGREEMENT FOR CY1975 HAS NOT BEEN ANNOUNCED BY ROKG DUE TO POSSIBLE SERIOUS DAMAGE TO INVESTOR/BANKER CONFIDENCE. WE UNDERSTAND IMF STAFF AND BOARD WISH AVOID ANY PUBLICITY FOR SAME REASON AND WE HAVE SEEN NO FOREIGN PRESS REPORTS. LOCAL PRESS AT END OF RECENT IMF VISIT REFERRED BRIEFLY AND GINGERLY TO PROPOSED EXTENSION TO JUNE 30 OF CY1975 STANDBY AGREEMENT (PREVIOUSLY REPORTED AS BEING IN EFFECT).

WE PLAN TO TREAT MATTER AS CONFIDENTIAL EXCEPT THAT, WHEN ASKED BY AMERICANS ON UNCLASSIFIED BASIS, WE PLAN ONLY TO SAY THAT WE UNDERSTAND THAT DELAY IN RATIFICATION LED TO DECISION TO SEEK NEW AGREEMENT COVERING JULY-JUNE PERIOD. WE HAVE NOT RECEIVED ANY INFORMATION OR GUIDANCE ON THIS DEVELOPMENT FROM WASHINGTON AND WOULD WELCOME ANY YOU MIGHT WISH TO PROVIDE.
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